(7)

No. 88-94

Supreme Court, U.S.
FILED
SEP 19 1988
JOSEPH F. SPANIOL, JR.
CLERK

In The Supreme Court of the United States

OCTOBER TERM, 1988

KENTUCKY WEST VIRGINIA GAS COMPANY
AND
EQUITABLE GAS COMPANY, a division of
EQUITABLE RESOURCES, INC.
Petitioners,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,
et al.
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR UNITED DISTRIBUTION COMPANIES AS AMICI CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

WILLIAM E. ZEITER*
ROBERTA LEE HALLADAY
JOHN F. STILLMUN, III

MORGAN, LEWIS & BOCKIUS
2000 One Logan Square
Philadelphia, PA 19103
(215) 963-5367

and

1800 M Street, N.W.
Washington, D.C. 20036

Attorneys for Amici Curiae
United Distribution Companies

September 19, 1988

*Counsel of Record

TABLE OF CONTENTS

	Page
Table of Authorities	ii
Interest of Amici Curiae	1
Reasons for Granting the Writ	3
Conclusion	10

TABLE OF AUTHORITIES

CASES:	Page
In re Columbia Gas of West Virginia, Inc., 47 PUR 4th 392 (1982)	9
Duquesne Power & Light v. Barasch, No. 87-1160, *prob. juris. noted*, 108 S.Ct. 1105 (1988)	4, 10
Mississippi Power & Light Co. v. Mississippi, 108 S.Ct. 2428 (1988)	3, 4, 5, 10
Mullane v. Central Hanover Trust Co., 308 U.S. 306 (1950)	6
Nantahala Power & Light Co. v. Thornburg, 476 U.S. 953 (1986)	4
In re National Fuel Gas Corp., 32 F.E.R.C. (CCH) ¶ 61,226 (1985)	6
Wisconsin Gas Co. v. FERC, 770 F.2d 1144 (1985), *cert. denied*, 476 U.S. 1114 (1986)	5
STATUTES AND REGULATIONS:	
Act 1984-74, 66 Pa.C.S. § 1307(f), 1317-18	4
Natural Gas Act, 15 U.S.C. § 717 *et seq.*	3
Natural Gas Policy Act, 15 U.S.C. § 3301 *et seq.*	5
18 C.F.R. § 157.14(a)(ii)(v)	6
MISCELLANEOUS:	
Berry, *Least-Cost Planning and Utility Regulation*, PUB. UTIL. FORT., Mar. 17, 1988	9
Smoots, *Report on State Least-Cost Gas Purchasing Requirements*, 2 NAT. GAS LAW. J. 110 (1987)	8

In The Supreme Court Of The United States

OCTOBER TERM, 1988

No. 88-94

KENTUCKY WEST VIRGINIA GAS COMPANY
AND
EQUITABLE GAS COMPANY, A DIVISION OF
EQUITABLE RESOURCES, INC.

Petitioners,

V.

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *ET AL.*

Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

---

BRIEF FOR UNITED DISTRIBUTION COMPANIES AS AMICI CURIAE IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

Interest of Amici Curiae.[1]

United Distribution Companies ("UDC") is an *ad hoc* group of organizations that provide gas utility service to the general public. UDC was formed in 1969 and is comprised of 32 organizations that render in the aggregate more than 20% of all gas utility service throughout

[1]Each of the parties to this appeal has consented to the filing of this *amicus curiae* brief. These consents have been filed with the Court.

the United States.[2] The members of UDC render service in the states of Illinois, Indiana, Michigan, Missouri, New Jersey, New York, Ohio, Pennsylvania, West Virginia and Wisconsin. Petitioner Equitable Gas Company is a member of UDC.

The members of UDC operate in whole or in part as local distribution companies ("LDCs"). LDCs are public utilities that sell natural gas at retail to local consumers. State or local utility commissions regulate these

[2]The members of United Distribution Companies are:

Battle Creek Gas Company
Central Illinois Light Company
Central Illinois Public Service Company
Citizens Gas & Coke Utility
Citizens Gas Fuel Company
Consumers Power Company
The Dayton Power and Light Company
The East Ohio Gas Company
Equitable Gas Company
Hope Gas, Inc.
Illinois Power Company
Indiana Gas Company
Kokomo Gas and Fuel Company
Michigan Gas Company
Michigan Gas Utilities Company
National Fuel Gas Distribution Corporation
Niagara Mohawk Power Corporation
North Shore Gas Company
Ohio Gas Company
Orange & Rockland Utilities, Inc.
The Peoples Gas Light and Coke Company
The Peoples Natural Gas Company
Richmond Gas Corporation
The River Gas Company
Rochester Gas and Electric Corporation
Southeastern Michigan Gas Company
Union Electric Company
West Ohio Gas Company
Wisconsin Fuel and Light Company
Wisconsin Gas Company
Wisconsin Natural Gas Company
Wisconsin Southern Gas Company

retail sales. Each company is under a statutory duty within its respective state to provide service to any customer in its service area, and to obtain supplies of natural gas that are adequate to serve consumer demands. To carry out these statutory duties, each LDC must be afforded the opportunity to charge rates that recover all expenses that were reasonably incurred pursuant to the regulatory regime in existence at the time the expenditures were made.

At the same time, UDC members acquire much of their natural gas supplies through wholesale purchases from interstate pipelines. The Federal Energy Regulatory Commission ("FERC") regulates these interstate wholesale sales transactions pursuant to the Natural Gas Act, 15 U.S.C. § 717 *et seq.* In light of the federal regulation of interstate wholesale sales of natural gas and the state or local regulation of retail sales, UDC members are particularly susceptible to being "trapped," *Mississippi Power and Light Co. v. Mississippi*, 108 S.Ct. 2428, 2439 (1988) by state or local regulatory policies and procedures that prevent LDCs from recovering the cost of paying federally-approved rates for gas purchased in a wholesale sales transaction. As *Amici* demonstrate below, the likelihood of such "trapping" of costs has increased dramatically as more states pursue least cost gas procurement policies. *Amici*, therefore, have a direct and substantial interest in this case.

Reasons for Granting the Writ.

This case presents an important opportunity for this Court to clarify how two federal principles apply to the implementation of state policies and procedures for regulating LDCs.

One principle is the doctrine of federal preemption. Although this Court has recently reaffirmed that "states may not bar regulated utilities from passing through to retail customers FERC-mandated wholesale rates," *Mississippi Power*, 108 S.Ct. at 2439, the decision of the Court of Appeals below has permitted Pennsylvania to implement a statute establishing a least cost gas purchasing policy for LDCs[3] in a manner that has "trapped" petitioner Equitable by denying recovery of expenses Equitable was obligated to incur pursuant to the minimum bill requirements in the federally-approved tariff of one of Equitable's interstate pipeline gas suppliers. The Court of Appeals' decision thus stands in the way of a clear understanding and application of this Court's decisions in *Mississippi Power* and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986).

The other principle that requires clarification is one of federal takings law. The decision of the Court of Appeals has permitted Pennsylvania to confiscate Equitable's investment by changing retroactively the applicable ratemaking rules after Equitable had already incurred significant expenses to secure gas supplies in furtherance of its statutory duty to serve. This unconstitutional regulatory treatment parallels Pennsylvania's result-oriented treatment of electric utility cancellation costs in *Duquesne Light Co. v. Barasch*, No. 87-1160, *prob. juris. noted*, 108 S.Ct. 1105 (1988). In *Duquesne*, Pennsylvania applied a new statute barring recovery of investment in cancelled electric generating plants after the utilities had incurred such investment and after the plants in question

[3]Pennsylvania Act 1984-74, 66 Pa.C.S. § 1307(f), 1317-18 (hereinafter "Act 74").

had been found to be prudently cancelled. By applying its least cost purchasing policy retroactively to Equitable's gas purchases made before Act 74 was enacted, Pennsylvania in this case has once again manipulated a seemingly straightforward new ratemaking method in an effort to minimize the resulting rates paid by its consumers.

The Court's intervention is necessary to enlighten state regulators concerning how these important principles of federal law apply to an area of state regulation that is expanding rapidly across the nation. *Amici*, therefore, join in petitioners' request that the petition for writ of certiorari be granted, the judgment of the Court of Appeals vacated, and the case remanded for reconsideration in light of *Mississippi Power*, or, in the alternative, that the petition be granted for consideration of the takings issue or held for disposition as appropriate in light of the decision on this issue in *Duquesne*.

1. The market pressures that resulted in Pennsylvania's adoption of a least cost gas procurement policy are nationwide in scope. The partial deregulation of wellhead natural gas prices caused by the enactment of Natural Gas Policy Act, 15 U.S.C. §§ 3301 *et seq.*, and the reduction in demand for natural gas caused by declining oil prices and other factors, produced a sharp swing in the natural gas market. The United States Court of Appeals for the District of Columbia Circuit observed that "the net result of these converging factors was to convert the gas supply shortage of 1977 to 1978 to the gas supply surplus of 1982 to 1985." *Wisconsin Gas. Co. v. FERC*, 770 F.2d 1144, 1151 (1985), *cert. denied* 476 U.S. 1114 (1986).

This change in market conditions has spurred regulators interested in minimizing retail natural gas rates to develop regulatory policies and procedures designed to encourage LDCs to abandon long-term supply arrangements in favor of short-term purchases in the lower-cost spot market. Natural gas supply planning necessarily involves tradeoffs between long-term reliability and short-term costs. State regulation may allocate between these competing concerns as long as the LDCs are afforded notice of what conduct the state will require of it, *cf. Mullane v. Central Hanover Trust Co.*, 339 U.S. 306 (1950), and the state's action is consistent with applicable federal regulatory requirements.

2. When the wholesale market for natural gas was characterized by shortages, LDCs were under pressure to enter into long-term supply contracts in order to secure a stable supply of natural gas to meet their statutory duty to serve.[4] By the time when the market changed and abundant supplies of natural gas became available, many LDCs had already prudently entered into contracts containing specific purchase requirement provisions, such as the minimum bill provisions in

[4]Indeed, federal regulations place interstate pipelines under pressure to secure long-term contracts from their LDC customers. *See e.g.*, 18 C.F.R. § 157.14(a)(11)(v). Section 157.14(a)(11)(v) requires pipelines seeking a certificate of public convenience to include in their application:

> Conformed copy of each contract, letter of intent or other agreement for sale or transportation of natural gas proposed by the application. Indicate the rate to be charged. If no agreements have been made, indicate the basis for assuming that contracts will be consummated and that service will be rendered under the terms contemplated in the application.

Id. FERC will dismiss an application for a certificate of public convenience where the pipeline is unable to "show that a committed market exists for its sales." *In re National Fuel Gas Corp.*, 32 F.E.R.C. (CCH) ¶ 61,226 at 61,522 (1985).

Equitable's contracts, that had become embodied in FERC-approved tariffs. The unforeseen and rapid change in the level of natural gas supplies available for sale, however, put strong public pressure on states to develop policies that would take advantage of the gas supply surplus and would lead to lower retail natural gas rates in rapid fashion.

The shift in regulatory emphasis toward short-term cost minimization is understandable. Nonetheless, any shift in state regulation of LDC purchasing practices must be consistent with federal policies and regulations that govern wholesale sales of natural gas. When states move too hastily in pursuing policies aimed at cost minimization, they can easily intrude upon federal policies and regulatory requirements. For example, as evidenced by the case at the bar, a change in state regulatory policy on LDC purchasing practices can impose new duties on LDCs that conflict with the LDCs' existing purchase obligations under the wholesale sales tariffs that are regulated and approved by FERC. States cannot be permitted to implement least cost policies in ways that entrap LDCs and deny them the right to recover costs assessed by their pipeline suppliers under FERC-approved tariffs.

Similarly, state regulators risk conflicting with the federal constitution when they move too hastily to implement a change in policy without prior notice to the utility. As evidenced by the case at bar, when a state implements a change in policy after an LDC has secured long-term supply contracts with minimum bill provisions that are embodied in a FERC-approved tariff, that change may confiscate the LDC's investment by preventing it from recovering an unavoidable cost of

doing business. Under such circumstances, the retroactive implementation of new state ratemaking requirements interferes with the constitutional rights of the LDC's investors.

3. Pennsylvania is not alone in recently implementing a least cost purchasing policy in response to the radical changes in the natural gas market. More than a dozen states within the last five years have enacted statutes or adopted regulations directing utilities to pursue least cost purchasing strategies, and have implemented regulatory procedures for the review of LDC gas purchasing decisions. *See* Smoots, *Report on State Least-Cost Gas Purchasing Requirements*, 2 NAT. GAS LAW. J. 110 (1987). As a result,

> [e]xplicit limitations on the gas purchasing practices of distributors are both increasingly common and of increasing importance to the gas industry. Although most states have traditionally reviewed distributor gas purchasing as part of the rate consideration process, never before has this oversight been as intensive, systematic and broad-based.

Id. at 110.

Moreover, the regulatory concept of least cost utility planning is a methodology that is becoming increasingly prevalent in all areas of regulation. The recent decline in oil prices, and the escalation in the cost of nuclear plant capacity prices have induced many regulators to adopt least-cost planning programs in the electric utility area as well. A survey conducted by the Arizona Corporation Commission found that 16 states had implemented some form of least cost planning programs with respect to their electric utilities, 9 states were in the process of developing such programs, and

5 states were considering the development of such programs. *See* Berry, *Least-Cost Planning and Utility Regulation,* PUB. UTIL. FORT., Mar. 17, 1988 at 9. The regulatory procedures at issue in this case, therefore, have significance in many areas of utility regulation.

4. The decision in this case will send a signal to state regulators concerning the manner in which such changes in regulatory policy should be implemented in order to be consistent with federal law. Given the proliferation of state regulatory approaches that embody the concept of least cost purchasing, the frequency of regulatory action such as that undertaken in the case at bar is likely to increase dramatically.

The case at bar stands in sharp contrast to cases in other jurisdictions where least cost purchasing policies have been applied only in a prospective manner. *See e.g., In re Columbia Gas of West Virginia, Inc.,* 47 PUR4th 392 (1982). In *Columbia Gas,* the West Virginia Public Service Commission expressly declined to apply its least cost purchasing policy retroactively and declined to adjust the utility's rates because "the new standards of care established in this order are standards of which Columbia has not had notice prior to issuance of this order." *Id.* at 440.

If the decision of the Court of Appeals in the present case is permitted to stand, jurisdictions adopting new regulatory approaches would be free to ignore the considered approach taken in West Virginia. Instead, states would be encouraged to implement new approaches in a way that blindsides the utilities and saddles them with costs that are part of a FERC-approved tariff and, as such, are not avoidable. The decision be-

low should be vacated in order to inform state regulators that changes in policy must be implemented in a manner designed to avoid interfering with federally-approved rates and the constitutional rights of public utility investors.

CONCLUSION

The petition for a writ of certiorari should be granted, the judgment of the court of appeals vacated, and the case remanded for reconsideration in light of *Mississippi Power & Light Co. v. Mississippi*, 108 S. Ct. 2428 (1988). In the alternative, the Court should grant the petition or hold it for disposition as appropriate in light of the decision in *Duquesne Light Co. v. Barasch*, No. 87-1160 *prob. juris. noted*, 108 S.Ct. 1105 (1988).

Respectfully submitted,

WILLIAM E. ZEITER*
ROBERTA LEE HALLADAY
JOHN F. STILLMUN, III

MORGAN, LEWIS & BOCKIUS
2000 One Logan Square
Philadelphia, PA 19103
(215) 963-5367
and
1800 M Street, N.W.
Washington, D.C. 20036

Attorneys for Amici Curiae
United Distribution Companies

September 19, 1988

*Counsel of Record